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INDIA MUST GET ITS MANUFACTURING POLICY RIGHT THIS TIME

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Industry & Services Sector incl. MSMEs and PSUs

Strengthen local production by fixing incentives for our policy of self-reliance to achieve its objectives

Two headlines in Mint (17 December 2020) point to a window of opportunity for India to fix a festering problem of its economy. The first: “India in a Deglobalizing World"; and the second: “PLI Wind in Sails for India Inc." India’s manufacturing sector lacks sufficient depth for a large country. Depth in manufacturing provides security against foreign threats; it is the foundation for sustainable competitiveness in international trade; and it provides pathways for wages to rise. India needs all the three and now is the time to address this.

China and India are the only two countries in the world with populations of over one billion. These provide a large potential market; also, a large workforce to produce for the world market and for their own. The growth trajectories of the Asian neighbours reveal how far behind India has fallen over the past three decades. In 1990, India’s manufacturing sector was comparable with China’s. Since then, China’s manufacturing sector has grown almost 10 times larger, and its capital goods and machine-tool sectors, 50 times. Not only has China become the factory of the world, selling labour-intensive products across the planet, it has also developed high-tech manufacturing capabilities in electronics, telecom, power equipment and machine tools. It is this depth of its manufacturing capabilities that has made it a threat to the West (and to India, too).

In the 1990s, after the fall of the Soviet Union, globalization of trade and investment went into high gear. All countries were pressed to open their borders. China, humiliated by the forcible opening of its markets by Western gunboats long earlier, was determined to build its internal strengths to join global trade on its own terms this time round. India joined the global trade regime more willingly. Both countries’ consumers have benefitted from the availability of a greater variety of goods. However, the Chinese have gained much more by way of increases in their incomes, because they produce much more than Indians do.

Indian policymakers are concerned with sluggishness in the growth of domestic manufacturing and employment. They are alarmed by the inroads of Chinese industries in India’s economy, as well as by China’s troops on the border. An Atmanirbhar policy and ‘Make in India’ have become national-security imperatives. While India is being criticized—by its own economists—for turning protectionist again, other nations have been closing up faster. A Mint report cited earlier ranks countries on a ‘protectionist index’, the difference between their number of restrictive and liberalizing interventions between 2018 and 2020. On top is the US, with 591. Then Canada, 450; Germany, 436; the UK, 272; and China, 209. India? 166.

More trade is good, as is faster economic growth. However, the pattern of trade and the composition of growth matter even more for all-round development. Therefore, trade theorists would do well to learn from history about how the Chinese built their industrial strengths, and before them the Western nations that set international trade rules.

India’s Production Linked Incentive (PLI) scheme is a thrust in the right direction. However, its success in making India more self-reliant would depend on its design. Incentives linked only to volumes of additional production (and exports) will promote simple assembly and other low-value-adding operations. This would not meet India's strategic need for industrial depth. The incentives must be tied to progressive increases in value addition within the country.

One, the present policy does not explicitly link the quantum of incentive with domestic value-addition. PLI payments should be made to companies in proportion to their domestic value-addition, with a minimum requirement. This way, companies doing assembly/low-level manufacturing will have lower value-addition and hence get less of an incentive.

Two, in the current policy, the PLI incentive is determined by the percentage increase in production over a base year. Production in that base year should not be zero (or a very low level) because even small additions will amount to large percentage increases. Therefore, there should be a minimum threshold level. This will also ensure that the company already has some track record of growth and uses the incentives well for further expansion.

Three, domestic research and development (R&D) is essential for the absorption of technology and acquisition of sustainable competitiveness. R&D (including manpower) spend should be seen as a capital investment. Such investment can generate at least a five-times-greater return on investment, compared to other forms of capital investment (plant and machinery, etc.) in knowledge-driven industries.

Four, the PLI scheme is intended to attract foreign direct investment (FDI) and scale up the domestic industry. To ensure that both are equally promoted (and not one at the expense of the other), perhaps 50% of the PLI incentive should be reserved for domestic companies.

Lastly, the only sustainable competitive advantage a company or a country can have in open markets is an ability to learn faster than competitors. Enterprises in India must become the fastest learners in the world to catch up with their Chinese counterparts, among others. India's policymakers must also become much faster learners, and not remain stuck in the theoretical paradigm of free trade that has not served India too well.

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